UNION BANKSHARES INC
Form 10-Q
May 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: March 31, 2013

Commission file number: 001-15985

UNION BANKSHARES, INC.
VERMONT 03-0283552

P.O. BOX 667
20 LOWER MAIN STREET
MORRISVILLE, VT 05661

Registrant's telephone number: 802-888-6600

Former name, former address and former fiscal year, if changed since last report: Not applicable

Securities registered pursuant to section 12(b) of the Act:

Common Stock, $2.00 par value	Nasdaq Stock Market
(Title of class)	(Exchanges registered on)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of May 1, 2013:

Common Stock, $2 par value	4,456,956 shares

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements
UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	March 31, 2013 (Unaudited)	December 31, 2012
	(Dollars in thousands)	
Assets		
Cash and due from banks	$4,127	$5,023
Federal funds sold and overnight deposits	25,159	41,487
Cash and cash equivalents	29,286	46,510
Interest bearing deposits in banks	22,275	21,922
Investment securities available-for-sale	27,022	20,630
Investment securities held-to-maturity (fair value $7.9 million and $5.5 million at March 31, 2013 and December 31, 2012, respectively)	7,993	5,496
Loans held for sale	10,828	11,014
Loans	438,985	444,145
Allowance for loan losses	(4,714)	(4,657)
Net deferred loan costs	154	139
Net loans	434,425	439,627
Accrued interest receivable	1,813	1,539
Premises and equipment, net	10,304	10,289
Core deposit intangible	1,395	1,438
Goodwill	2,223	2,223
Investment in real estate limited partnerships	3,636	3,809
Company-owned life insurance	3,291	3,267
Other assets	8,247	9,492
Total assets	$562,738	$577,256
Liabilities and Stockholders’ Equity		
Liabilities		
Deposits		
Noninterest bearing	$80,300	$83,715
Interest bearing	266,649	273,505
Time	149,291	152,773
Total deposits	496,240	509,993
Borrowed funds	14,532	15,747
Liability for defined benefit pension plan	2,773	2,753
Accrued interest and other liabilities	3,540	3,717
Total liabilities	517,085	532,210
Commitments and Contingencies		
Stockholders’ Equity		
Common stock, $2.00 par value; 7,500,000 shares authorized; 4,924,986 shares issued at March 31, 2013 and 4,923,986 shares issued at December 31, 2012	9,850	9,848
Additional paid-in capital	316	295
Retained earnings	41,395	40,772
Treasury stock at cost; 468,580 shares at March 31, 2013 and 467,905 shares at December 31, 2012	(3,872)	(3,859)
Accumulated other comprehensive loss	(2,036)	(2,010)
Total stockholders' equity	45,653	45,046

Total liabilities and stockholders' equity	$562,738	$577,256

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended March 31, 2013	2012
	(Dollars in thousands except per share data)	
Interest and dividend income		
Interest and fees on loans	$5,668	$5,810
Interest on debt securities:		
Taxable	110	199
Tax exempt	70	88
Dividends	16	18
Interest on federal funds sold and overnight deposits	13	4
Interest on interest bearing deposits in banks	60	77
Total interest and dividend income	5,937	6,196
Interest expense		
Interest on deposits	518	660
Interest on borrowed funds	130	250
Total interest expense	648	910
Net interest income	5,289	5,286
Provision for loan losses	60	180
Net interest income after provision for loan losses	5,229	5,106
Noninterest income		
Trust income	163	147
Service fees	1,189	1,175
Net gains on sales of investment securities available-for-sale	3	42
Net gains on sales of loans held for sale	667	473
Other income	134	66
Total noninterest income	2,156	1,903
Noninterest expenses		
Salaries and wages	2,157	2,234
Pension and employee benefits	683	1,058
Occupancy expense, net	331	344
Equipment expense	426	345
Other expenses	1,582	1,560
Total noninterest expenses	5,179	5,541
Income before provision for income taxes	2,206	1,468
Provision for income taxes	469	241
Net income	$1,737	$1,227
Earnings per common share	$0.39	$0.28
Weighted average number of common shares outstanding	4,455,822	4,457,081
Dividends per common share	$0.25	$0.25

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended March 31,	
	2013	2012
	(Dollars in thousands)	
Net income	$1,737	$1,227
Other comprehensive income (loss), net of tax:		
Investment securities available-for-sale:		
Net unrealized holding gains (losses) arising during the period on investment securities available-for-sale	9	(38)
Reclassification adjustments for net gains on investment securities available-for-sale realized in net income	(2)	(28)
Total	7	(66)
Defined benefit pension plan:		
Net actuarial (loss) gain arising during the period	(26)	26
Reclassification adjustment for amortization of net actuarial (gain) loss realized in net income	(7)	90
Reclassification adjustment for amortization of prior service cost realized in net income	—	1
Total	(33)	117
Total other comprehensive (loss) income	(26)	51
Total comprehensive income	$1,711	$1,278

See accompanying notes to unaudited interim consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2013 and 2012 (Unaudited)

	Common Stock						
	Shares, net of treasury	Amount	Additional paid-in capital	Retained earnings	Treasury stock	Accumulated other comprehensive loss	Total stockholders' equity
	(Dollars in thousands except per share data)						
Balances, December 31, 2012	4,456,081	$9,848	$295	$40,772	$(3,859)	$(2,010)	$45,046
Net income	—	—	—	1,737	—	—	1,737
Other comprehensive loss	—	—	—	—	—	(26)	(26)
Cash dividends declared ($0.25 per share)	—	—	—	(1,114)	—	—	(1,114)
Stock based compensation expense	—	—	3	—	—	—	3
Exercise of stock options	1,000	2	18	—	—	—	20
Purchase of treasury stock	(675)	—	—	—	(13)	—	(13)
Balances, March 31, 2013	4,456,406	$9,850	$316	$41,395	$(3,872)	$(2,036)	$45,653
Balances, December 31, 2011	4,457,204	$9,847	$276	$38,385	$(3,823)	$(4,346)	$40,339
Net income	—	—	—	1,227	—	—	1,227
Other comprehensive income	—	—	—	—	—	51	51
Cash dividends declared ($0.25 per share)	—	—	—	(1,114)	—	—	(1,114)
Stock based compensation expense	—	—	4	—	—	—	4
Purchase of treasury stock	(700)	—	—	—	(13)	—	(13)
Balances, March 31, 2012	4,456,504	$9,847	$280	$38,498	$(3,836)	$(4,295)	$40,494

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31, 2013	2012
	(Dollars in thousands)	
Cash Flows From Operating Activities		
Net income	$1,737	$1,227
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	239	200
Provision for loan losses	60	180
Deferred income tax provision (benefit)	141	(156)
Net amortization of investment securities	12	26
Equity in losses of limited partnerships	172	158
Stock based compensation expense	3	4
Net (increase) decrease in unamortized loan costs	(15)	26
Proceeds from sales of loans held for sale	34,345	22,865
Origination of loans held for sale	(33,492)	(29,588)
Net gains on sales of loans held for sale	(667)	(473)
Net loss on disposals of premises and equipment	—	1
Net gains on sales of investment securities available-for-sale	(3)	(42)
Write-downs of impaired assets	11	11
Net losses on sales of other real estate owned	5	6
Increase in accrued interest receivable	(274)	(76)
Amortization of core deposit intangible	43	43
Decrease in other assets	536	366
(Decrease) increase in other liabilities	(206)	322
Net cash provided by (used in) operating activities	2,647	(4,900)
Cash Flows From Investing Activities		
Interest bearing deposits in banks		
Proceeds from maturities and redemptions	1,787	1,836
Purchases	(2,140)	(1,298)
Investment securities held-to-maturity		
Proceeds from maturities, calls and paydowns	500	1,000
Purchases	(2,996)	—
Investment securities available-for-sale		
Proceeds from sales	510	789
Proceeds from maturities, calls and paydowns	1,636	2,718
Purchases	(8,539)	(3,834)
Redemption of nonmarketable stock	176	121
Net decrease (increase) in loans	5,146	(1,180)
Recoveries of loans charged off	11	10
Purchases of premises and equipment	(254)	(1,406)
Investments in limited partnerships	—	(486)
Proceeds from sales of other real estate owned	367	32
Net cash used in investing activities	(3,796)	(1,698)

Cash Flows From Financing Activities		
Repayment of long-term debt	(179)	(483)
Net decrease in short-term borrowings outstanding	(1,036)	(1,251)
Net decrease in noninterest bearing deposits	(3,415)	(1,145)
Net (decrease) increase in interest bearing deposits	(6,856)	10,254
Net decrease in time deposits	(3,482)	(4,538)
Issuance of common stock	20	—
Purchase of treasury stock	(13)	(13)
Dividends paid	(1,114)	(1,114)
Net cash (used in) provided by financing activities	(16,075)	1,710
Net decrease in cash and cash equivalents	(17,224)	(4,888)
Cash and cash equivalents		
Beginning of period	46,510	24,381
End of period	$29,286	$19,493
Supplemental Disclosures of Cash Flow Information		
Interest paid	$581	$818
Income taxes paid	$50	$75

See accompanying notes to unaudited interim consolidated financial statements.

UNION BANKSHARES, INC. AND SUBSIDIARY
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation
The accompanying unaudited interim consolidated financial statements of Union Bankshares, Inc. and Subsidiary (the Company) as of March 31, 2013, and for the three months ended March 31, 2013 and 2012, have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim financial information, general practices within the banking industry, and the accounting policies described in the Company’s Annual Report to Shareholders and Annual Report on Form 10-K for the year ended December 31, 2012. In the opinion of the Company’s management, all adjustments, consisting only of normal recurring adjustments and disclosures necessary for a fair presentation of the information contained herein, have been made. This information should be read in conjunction with the Company’s 2012 Annual Report to Shareholders and 2012 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2013, or any other interim period.

Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to the 2013 presentation.

Note 2. Legal Contingencies
In the normal course of business, the Company is involved in various legal and other proceedings. In the opinion of management, any liability resulting from such proceedings is not expected to have a material adverse effect on the Company’s consolidated financial condition or results of operations.

Note 3. Per Share Information
Earnings per common share are computed based on the weighted average number of shares of common stock outstanding during the period and reduced for shares held in treasury. The assumed conversion of available outstanding stock options does not result in material dilution and is not included in the calculation.

Note 4. Recent Accounting Pronouncements

In January 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-01, “Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities.” This ASU amends the scope of FASB ASU No. 2011-11, “Disclosures about Offsetting Assets and Liabilities,” which requires additional disclosure regarding offsetting of assets and liabilities to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. The provisions of the ASUs were effective for annual and interim reporting periods beginning on or after January 1, 2013. As the ASUs address financial statement disclosures only, their adoption effective January 1, 2013 did not impact the Company's consolidated financial position or results of operations.

In February 2013, the FASB issued ASU No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” This ASU adds new disclosure requirements for items reclassified out of accumulated other comprehensive income to be in a single location in the financial statements. The Company's disclosures of the components of accumulated other comprehensive income are disclosed in its Consolidated Statements of Comprehensive Income. For the three months ended March 31, 2013, the items requiring reclassification out of accumulated other comprehensive income are disclosed in Note 10. The new guidance became effective for all interim and annual periods beginning January 1, 2013. Since this ASU addresses financial statement disclosures only, the adoption of this guidance effective January 1, 2013 did not have an impact on the Company's consolidated financial position or results of operations.

Note 5. Goodwill and Other Intangible Assets

As a result of the acquisition of three New Hampshire branches in May 2011, the Company recorded goodwill amounting to $2.2 million. The goodwill is not amortizable. Goodwill is evaluated for impairment annually, in accordance with current authoritative guidance. Management assesses qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the Company, in total, is less than its carrying amount. Management is not aware of any such events or circumstances that would cause it to conclude that the fair value of the Company is less than its carrying amount.

The Company also recorded $1.7 million of acquired identifiable intangible assets in connection with the branch acquisition, representing the core deposit intangible which is subject to straight-line amortization over the estimated 10 year average life of the core deposit base, absent any future impairment. Management will evaluate the core deposit intangible for impairment if conditions warrant.

Amortization expense for the core deposit intangible was $43 thousand for the three months ended March 31, 2013 and 2012. The amortization expense is included in other noninterest expense on the consolidated statement of income and is deductible for tax purposes. As of March 31, 2013, the remaining amortization expense related to the core deposit intangible, absent any future impairment, is expected to be as follows:

	(Dollars in thousands)
2013	$128
2014	171
2015	171
2016	171
2017	171
Thereafter	583
Total	$1,395

Note 6. Investment Securities

Investment securities as of the balance sheet dates consisted of the following:

March 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$10,498	$19	$(31)	$10,486
Agency mortgage-backed	1,702	32	—	1,734
State and political subdivisions	9,796	664	(6)	10,454
Corporate	3,305	18	(47)	3,276
Total debt securities	25,301	733	(84)	25,950
Marketable equity securities	746	137	(5)	878
Mutual funds	194	—	—	194
Total	$26,241	$870	$(89)	$27,022
Held-to-maturity				
U.S. Government-sponsored enterprises	$7,993	$11	$(71)	$7,933

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available-for-sale				
Debt securities:				
U.S. Government-sponsored enterprises	$4,500	$22	$(3)	$4,519
Agency mortgage-backed	1,343	36	—	1,379
State and political subdivisions	9,803	664	(5)	10,462
Corporate	3,294	28	(22)	3,300
Total debt securities	18,940	750	(30)	19,660
Marketable equity securities	746	66	(15)	797
Mutual funds	173	—	—	173
Total	$19,859	$816	$(45)	$20,630
Held-to-maturity				
U.S. Government-sponsored enterprises	$5,496	$3	$(22)	$5,477

Proceeds from the sale of securities available-for-sale were $510 thousand and $789 thousand for the three month periods ended March 31, 2013 and March 31, 2012, respectively. Gross realized gains from the sale of securities available-for-sale were $3 thousand and $42 thousand for the three month periods ended March 31, 2013 and March 31, 2012, respectively. There were no gross realized losses for the three month periods ended March 31, 2013 and March 31, 2012. The specific identification method is used to determine realized gains and losses on sales of securities available-for-sale.

The amortized cost and estimated fair value of debt securities by contractual scheduled maturity as of March 31, 2013 were as follows:

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Available-for-sale		
Due in one year or less	$190	$193
Due from one to five years	2,854	2,916
Due from five to ten years	8,404	8,597
Due after ten years	12,151	12,510
	23,599	24,216
Agency mortgage-backed securities	1,702	1,734
Total debt securities available-for-sale	$25,301	$25,950
Held-to-maturity		
Due from one to five years	$996	$999
Due from five to ten years	2,000	2,003
Due after ten years	4,997	4,931
Total debt securities held-to-maturity	$7,993	$7,933

Actual maturities may differ for certain debt securities that may be called by the issuer prior to the contractual maturity. Actual maturities usually differ from contractual maturities on agency mortgage-backed securities because the mortgages underlying the securities may be prepaid, usually without any penalties. Therefore, these agency mortgage-backed securities are shown separately and not included in the contractual maturity categories in the above maturity summary.

Information pertaining to all investment securities with gross unrealized losses as of the balance sheet dates, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

March 31, 2013	Less Than 12 Months		12 Months and over		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars in thousands)					
Debt securities:						
U.S. Government-sponsored enterprises	$8,395	$(102)	$—	$—	$8,395	$(102)
State and political subdivisions	599	(6)	—	—	599	(6)
Corporate	2,752	(47)	—	—	2,752	(47)
Total debt securities	11,746	(155)	—	—	11,746	(155)
Marketable equity securities	—	—	44	(5)	44	(5)
Total	$11,746	$(155)	$44	$(5)	$11,790	$(160)

December 31, 2012	Less Than 12 Months		12 Months and over		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(Dollars in thousands)					
Debt securities:						
U.S. Government-sponsored enterprises	$4,472	$(25)	$—	$—	$4,472	$(25)
State and political subdivisions	345	(5)	—	—	345	(5)
Corporate	2,266	(22)	—	—	2,266	(22)
Total debt securities	7,083	(52)	—	—	7,083	(52)
Marketable equity securities	91	(7)	42	(8)	133	(15)
Total	$7,174	$(59)	$42	$(8)	$7,216	$(67)

The Company evaluates all investment securities on a quarterly basis, and more frequently when economic conditions warrant, to determine if an other-than-temporary impairment exists. A debt security is considered impaired if the fair value is lower than its amortized cost basis at the report date. If impaired, management then assesses whether the unrealized loss is other-than-temporary.

An unrealized loss on a debt security is generally deemed to be other-than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an other-than-temporary impairment write-down is recorded, net of tax effect, through net income as a component of net other-than-temporary impairment losses in the consolidated statement of income, while the remaining portion of the impairment loss is recognized in other comprehensive income (loss), provided the Company does not intend to sell the underlying debt security and it is "more likely than not" that the Company will not have to sell the debt security prior to recovery.

Management considers the following factors in determining whether an other-than-temporary impairment exists and the period over which the debt security is expected to recover:

- The length of time, and extent to which, the fair value has been less than the amortized cost;
- Adverse conditions specifically related to the security, industry, or geographic area;
- The historical and implied volatility of the fair value of the security;
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The payment structure of the debt security and the likelihood of the issuer being able to make payments that may increase in the future;

- Failure of the issuer of the security to make scheduled interest or principal payments;
- Any changes to the rating of the security by a rating agency;
- Recoveries or additional declines in fair value subsequent to the balance sheet date; and
- The nature of the issuer, including whether it is a private company, public entity or government-sponsored enterprise, and the existence or likelihood of any government or third party guaranty.

At March 31, 2013, held-to-maturity and available-for-sale securities, consisting of nine U.S. Government-sponsored enterprise securities, two tax-exempt municipal securities, six corporate bonds, and two marketable equity securities, had aggregate unrealized losses of $160 thousand. The two marketable equity securities had continuous unrealized losses for longer than twelve months. The Company has the ability to hold such securities for the foreseeable future. No declines were deemed by management to be other-than-temporary at March 31, 2013.

Investment securities with a carrying amount of $5.5 million and $6.7 million at March 31, 2013 and December 31, 2012, respectively, were pledged as collateral for public deposits and for other purposes as required or permitted by law.

Note 7. Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their unpaid principal balances, adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.
Loan interest income is accrued daily on outstanding balances. The following accounting policies, related to accrual and nonaccrual loans, apply to all portfolio segments and loan classes. The Company considers its portfolio segments and loan classes to be the same. The accrual of interest is normally discontinued when a loan is specifically determined to be impaired and/or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Normally, any unpaid interest previously accrued on those loans is reversed against current period interest income. A loan may be restored to accrual status when its financial status has significantly improved and there is no principal or interest past due. A loan may also be restored to accrual status if the borrower makes six consecutive monthly payments or the lump sum equivalent. Income on nonaccrual loans is generally not recognized unless a loan is returned to accrual status or after all principal has been collected. Interest income generally is not recognized on impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Delinquency status is determined based on contractual terms for all portfolio segments and loan classes. Loans past due 30 days or more are considered delinquent.
Loan origination fees and direct loan origination costs are deferred and amortized as an adjustment of the related loan's yield using methods that approximate the interest method. The Company generally amortizes these amounts over the estimated average life of the related loans.
The loans purchased in the May 2011 acquisition of branches were recorded at $32.9 million, the estimated fair value at the time of purchase. The estimated fair value contains both accretable and nonaccretable components. The accretable component is amortized as an adjustment to the related loan yield over the average life of the loan. The nonaccretable component represents probable loss due to credit risk and is reviewed by management periodically and adjusted as deemed necessary. At the acquisition date, the fair value of the loans acquired resulted in an accretable loan premium component of $545 thousand, less a nonaccretable credit risk component of $318 thousand.

The following table summarizes activity in the accretable loan premium component for the acquired loan portfolio:

	For The Three Months Ended March 31,	
	2013	2012
	(Dollars in thousands)	
Balance at beginning of period	$454	$491
Loan premium amortization	(20)	(23)
Balance at end of period	$434	$468

Loan premium amortization has been charged to Interest and fees on loans on the Company's statements of income for the periods reported. The remaining accretable loan premium component balance was $434 thousand at March 31, 2013 and $454 thousand at December 31, 2012. The balance of the nonaccretable credit risk component was $296 thousand at March 31, 2013 and December 31, 2012. The net carrying amounts of the acquired loans were $22.0 million and $22.9 million at March 31, 2013 and December 31, 2012, respectively, and are included in the loan balances below.

The composition of Net loans as of the balance sheet dates was as follows:

	March 31, 2013	December 31, 2012
	(Dollars in thousands)	
Residential real estate	$156,799	$154,938
Construction real estate	27,773	36,018
Commercial real estate	197,999	197,240
Commercial	20,051	21,463
Consumer	5,654	6,065
Municipal	30,709	28,421
Gross loans	438,985	444,145
Allowance for loan losses	(4,714)	(4,657)
Net deferred loan costs	154	139
Net loans	$434,425	$439,627

Residential real estate loans aggregating $13.7 million and $11.4 million at March 31, 2013 and December 31, 2012, respectively, were pledged as collateral on deposits of municipalities. Qualified residential first mortgage loans held by Union may be pledged as collateral for borrowings from the Federal Home Loan Bank (FHLB) of Boston under a blanket lien.

A summary of current, past due and nonaccrual loans as of the balance sheet dates follows:

March 31, 2013	Current	30-59 Days	60-89 Days	90 Days and Over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$150,552	$3,880	$587	$90	$1,690	$156,799
Construction real estate	27,725	6	—	—	42	27,773
Commercial real estate	196,800	804	—	—	395	197,999
Commercial	19,336	260	384	—	71	20,051
Consumer	5,591	18	—	11	34	5,654
Municipal	30,709	—	—	—	—	30,709
Total	$430,713	$4,968	$971	$101	$2,232	$438,985

December 31, 2012	Current	30-59 Days	60-89 Days	90 Days and Over and accruing	Nonaccrual	Total
	(Dollars in thousands)					
Residential real estate	$148,479	$2,573	$1,274	$296	$2,316	$154,938
Construction real estate	35,944	24	6	—	44	36,018
Commercial real estate	193,079	2,943	812	—	406	197,240
Commercial	20,541	811	39	—	72	21,463
Consumer	6,012	31	10	11	1	6,065
Municipal	28,421	—	—	—	—	28,421
Total	$432,476	$6,382	$2,141	$307	$2,839	$444,145

Aggregate interest on nonaccrual loans not recognized was $1.1 million and $977 thousand as of March 31, 2013 and 2012, respectively, and $1.0 million as of December 31, 2012.

Note 8. Allowance for Loan Losses and Credit Quality

The allowance for loan losses is established for estimated losses in the loan portfolio through a provision for loan losses charged to earnings. For all loan classes, loan losses are charged against the allowance when management believes the loan balance is uncollectible or in accordance with federal guidelines. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level believed by management to be appropriate to absorb probable credit losses inherent in the loan portfolio as of the balance sheet date. The amount of the allowance is based on management's periodic evaluation of the collectability of the loan portfolio, including the nature, volume and risk characteristics of the portfolio, credit concentrations, trends in historical loss experience, estimated value of any underlying collateral, specific impaired loans and economic conditions. There has been no change to the methodology used to estimate the allowance for loan losses. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or other relevant factors.

In addition, various regulatory agencies, as an integral part of their examination process, regularly review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses, with a corresponding charge to earnings, based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

The allowance consists of specific, general and unallocated components. The specific component relates to the loans that are classified as impaired. Loans are evaluated for impairment and may be classified as impaired when management believes it is probable that the Company will not collect all the contractual interest and principal payments as scheduled in the loan agreement. Impaired loans may also include troubled loans that are restructured. A troubled debt restructuring occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. Troubled debt restructuring may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms (such as reduction of stated interest rates below market rates, extension of maturity that does not conform to the Company's policies, reduction of face amount of the loan, reduction of accrued interest, or reduction or deferment of loan payments), or a combination. A specific reserve amount is allocated to the allowance for individual loans that have been classified as impaired based on management's estimate of the fair value of the collateral for collateral dependent loans, an observable market price, or the present value of anticipated future cash flows. The Company accounts for the change in present value attributable to the passage of time in the loan loss reserve. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer, real estate or small balance commercial loans for impairment evaluation, unless such loans are subject to a restructuring agreement or have been identified as impaired as part of a larger customer relationship.

The general component represents the level of allowance allocable to each loan portfolio segment with similar risk characteristics and is determined based on historical loss experience, adjusted for qualitative factors, for each class of loan. Management deems a five year average to be an appropriate time frame on which to base historical losses for each portfolio segment. Qualitative factors considered include underwriting, economic and market conditions, portfolio composition, collateral values, delinquencies, lender experience and legal issues. The qualitative factors are determined based on the various risk characteristics of each portfolio segment. Risk characteristics relevant to each portfolio segment are as follows:

- Residential real estate - Loans in this segment are collateralized by owner-occupied 1-4 family residential real estate, second and vacation homes, 1-4 family investment properties, home equity and second mortgage loans. Repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, could have an effect on the credit quality of this segment.

- Construction real estate - Loans in this segment include residential and commercial construction properties, land and land development loans. Repayment is dependent on the credit quality of the individual borrower and/or the underlying cash flows generated by the properties being constructed. The overall health of the economy, including unemployment rates, housing prices, vacancy rates and material costs, could have an effect on the credit quality of this segment.

- Commercial real estate - Loans in this segment are primarily properties occupied by businesses or income-producing properties. The underlying cash flows generated by the properties may be adversely impacted by a downturn in the economy as evidenced by a general slowdown in business or increased vacancy rates which, in turn, could have an effect on the credit quality of this segment. Management requests business financial statements at least annually and monitors the cash flows of these loans.

- Commercial - Loans in this segment are made to businesses and are generally secured by nonreal estate assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer or business spending, could have an effect on the credit quality of this segment.

- Consumer - Loans in this segment are made to individuals for personal expenditures, such as an automobile purchase, and include unsecured loans. Repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment, could have an effect on the credit quality of this segment.

- Municipal - Loans in this segment are made to municipalities located within the Company's service area. Repayment is primarily dependent on taxes or other funds collected annually by the municipalities. Management considers there to be minimal risk surrounding the credit quality of this segment.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

All evaluations are inherently subjective as they require estimates that are susceptible to significant revision as more information becomes available or as changes occur in economic conditions or other relevant factors. Despite the allocation shown in the tables below, the Allowance for loan losses is general in nature and is available to absorb losses from any loan type.

Changes in the Allowance for loan losses, by class of loans, for the three months ended March 31, 2013 and 2012 were as follows:

For The Three Months Ended March 31, 2013	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2012	$1,291	$456	$2,532	$159	$39	$30	$150	$4,657
Provision (credit) for loan losses	(1)	(86)	190	15	(7)	2	(53)	60
Recoveries of amounts charged off	1	3	—	1	6	—	—	11
	1,291	373	2,722	175	38	32	97	4,728
Amounts charged off	(10)	—	—	—	(4)	—	—	(14)
Balance, March 31, 2013	$1,281	$373	$2,722	$175	$34	$32	$97	$4,714

For The Three Months Ended March 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
	(Dollars in thousands)							
Balance, December 31, 2011	$1,250	$367	$2,278	$232	$60	$21	$18	$4,226
Provision for loan losses	10	11	127	13	—	6	13	180
Recoveries of amounts charged off	—	3	—	3	4	—	—	10
	1,260	381	2,405	248	64	27	31	4,416
Amounts charged off	—	—	—	—	(10)	—	—	(10)
Balance, March 31, 2012	$1,260	$381	$2,405	$248	$54	$27	$31	$4,406

The allocation of the Allowance for loan losses, summarized on the basis of the Company's impairment methodology by class of loan, as of the balance sheet dates was as follows:

March 31, 2013	Residential Real Estate (Dollars in thousands)	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
Individually evaluated for impairment	$63	$23	$57	$3	$—	$—	$—	$146
Collectively evaluated for impairment	1,218	350	2,665	172	34	32	97	4,568
Total allocated	$1,281	$373	$2,722	$175	$34	$32	$97	$4,714
December 31, 2012	Residential Real Estate (Dollars in thousands)	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Unallocated	Total
Individually evaluated for impairment	$49	$18	$53	$—	$—	$—	$—	$120
Collectively evaluated for impairment	1,242	438	2,479	159	39	30	150	4,537
Total allocated	$1,291	$456	$2,532	$159	$39	$30	$150	$4,657

The recorded investment in loans, summarized on the basis of the Company's impairment methodology by class of loan, as of the balance sheet dates was as follows:

March 31, 2013	Residential Real Estate (Dollars in thousands)	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
Individually evaluated for impairment	$752	$142	$3,397	$122	$—	$—	$4,413
Collectively evaluated for impairment	147,544	27,624	182,283	19,477	5,448	30,201	412,577
	148,296	27,766	185,680	19,599	5,448	30,201	416,990
Acquired loans	8,503	7	12,319	452	206	508	21,995
Total	$156,799	$27,773	$197,999	$20,051	$5,654	$30,709	$438,985
December 31, 2012	Residential Real Estate (Dollars in thousands)	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
Individually evaluated for impairment	$703	$145	$3,427	$127	$—	$—	$4,402
Collectively evaluated for impairment	144,921	35,866	181,406	20,851	5,846	27,913	416,803
	145,624	36,011	184,833	20,978	5,846	27,913	421,205
Acquired loans	9,314	7	12,407	485	219	508	22,940
Total	$154,938	$36,018	$197,240	$21,463	$6,065	$28,421	$444,145

Risk and collateral ratings are assigned to loans and are subject to ongoing monitoring by lending and credit personnel with such ratings updated annually or more frequently if warranted. The following is an overview of the Company's loan rating system:

1-3 Rating - Pass
Risk-rating grades "1" through "3" comprise those loans ranging from those with lower than average credit risk, defined as borrowers with high liquidity, excellent financial condition, strong management, favorable industry trends

or loans secured by highly liquid assets, through those with marginal credit risk, defined as borrowers that, while creditworthy, exhibit some characteristics requiring special attention by the account officer.

4/M Rating - Satisfactory/Monitor
Borrowers exhibit potential credit weaknesses or downward trends warranting management's attention. While potentially weak, these borrowers are currently marginally acceptable; no loss of principal or interest is envisioned. When warranted, these credits may be monitored on the watch list.

5-7 Rating - Substandard
Borrowers exhibit well defined weaknesses that jeopardize the orderly liquidation of debt. The loan may be inadequately protected by the net worth and paying capacity of the obligor and/or the underlying collateral is inadequate.

The following tables summarize the loan ratings applied to the Company's loans by class as of the balance sheet dates:

March 31, 2013	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$134,490	$24,695	$126,950	$16,712	$5,310	$30,201	$338,358
Satisfactory/Monitor	11,042	2,782	49,074	2,418	123	—	65,439
Substandard	2,764	289	9,656	469	15	—	13,193
Total	148,296	27,766	185,680	19,599	5,448	30,201	416,990
Acquired loans	8,503	7	12,319	452	206	508	21,995
Total	$156,799	$27,773	$197,999	$20,051	$5,654	$30,709	$438,985

December 31, 2012	Residential Real Estate	Construction Real Estate	Commercial Real Estate	Commercial	Consumer	Municipal	Total
	(Dollars in thousands)						
Pass	$134,737	$30,115	$130,956	$18,258	$5,722	$27,913	$347,701
Satisfactory/Monitor	7,749	5,751	46,174	2,476	102	—	62,252
Substandard	3,138	145	7,703	244	22	—	11,252
Total	145,624	36,011	184,833	20,978	5,846	27,913	421,205
Acquired loans	9,314	7	12,407	485	219	508	22,940
Total	$154,938	$36,018	$197,240	$21,463	$6,065	$28,421	$444,145

Acquired loans are risk rated, as appropriate, according to the Company's loan rating system, but such ratings are not taken into account in establishing the allowance for loan losses. Rather, in accordance with applicable accounting principles, acquired loans are initially recorded at fair value, determined based upon an estimate of the amount and timing of both principal and interest cash flows expected to be collected and discounted using a market interest rate, which includes an estimate of future credit losses expected to be incurred over the life of the portfolio. The primary credit quality indicator for acquired loans is whether there has been a decrease in expected cash flows. Monitoring of this portfolio is ongoing to determine if there is evidence of deterioration in credit quality since acquisition. As of March 31, 2013, there was no allowance for loan losses for acquired loans.

The following table provides information with respect to impaired loans by class of loan as of and for the three months ended March 31, 2013:

	As of March 31, 2013			For The Three Months Ended March 31, 2013	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
With an allowance recorded:					
Residential real estate	$409	$418	$63		
Construction real estate	142	148	23		
Commercial real estate	2,362	2,397	57		
Commercial	122	122	3		
	3,035	3,085	146		
With no allowance recorded:					
Residential real estate	343	489	—		
Commercial real estate	1,035	1,122	—		
	1,378	1,611	—		
Total:					
Residential real estate	752	907	63	$728	$4
Construction real estate	142	148	23	143	1
Commercial real estate	3,397	3,519	57	3,412	29
Commercial	122	122	3	125	2
Total	$4,413	$4,696	$146	$4,408	$36

(1) Does not reflect government guaranties on impaired loans as of March 31, 2013 totaling $761 thousand.

The following table provides information with respect to impaired loans by class of loan as of and for the three months ended March 31, 2012:

	As of March 31, 2012			For The Three Months Ended March 31, 2012	
	Recorded Investment (1)	Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
Total:					
Residential real estate	$406	$419	$22	$412	$—
Commercial real estate	2,091	2,306	9	2,158	46
Total	$2,497	$2,725	$31	$2,570	$46

(1) Does not reflect government guaranties on impaired loans as of March 31, 2012 totaling $110 thousand.

The following table provides information with respect to impaired loans as of December 31, 2012:

	December 31, 2012		
	Recorded Investment (1)	Principal Balance (1)	Related Allowance
	(Dollars in thousands)		
With an allowance recorded:			
Residential real estate	$354	$360	$49
Construction real estate	145	150	18
Commercial real estate	2,380	2,411	53
	2,879	2,921	120
With no allowance recorded:			
Residential real estate	349	491	—
Commercial real estate	1,047	1,133	—
Commercial	127	127	—